

GX 1510



UBS Investment Research

Doral Financial

4Q 2004 Results: Handily Beats Estimates, With Lots Of (Good) Noise

■ Doral Reported 4Q04 Earnings of \$1.22, \$0.18 above consensus

After market close today, Doral reported 4th quarter EPS of \$1.22, beating consensus estimates of \$1.04, and UBS estimate of \$1.02. Mortgage loan origination and credit quality remained strong.

■ Record Earnings Due To Tax Benefit Which Expires June 2005

4Q earnings were boosted by a \$77 million tax benefit from a temporary 50% reduction in long term capital gains rates by the local government. This gain offset a \$97.5 pre tax loss (\$79 after tax) from the writedown of interest-only strips. Aggressive use of this tax break in the next six months could lower tax rates in 2005.

■ I/O Writedown Is Conservative, Creating Upside Potential

We spoke with management about the I/O writedown, and are no longer concerned that it relates to an issue with the company's hedging program. The writedown is due to Doral's conservative approach to valuing its excess servicing asset. We expect that there is potential for a portion of the charge to be recovered in 2005, if interest rates do not rise as quickly as anticipated.

■ Valuation: Maintaining 2005E EPS of \$4.55, \$60 price target

We are maintaining our 2005E EPS estimate of \$4.55 and price target of \$60. We are now even more comfortable with our earnings estimate, as we believe that the potential for upside is now even more pronounced. Our \$60 price target is based on 11x forward PE on our 2006E EPS of \$5.44.

Highlights (US\$m)	12/02	12/03	12/04E	12/05E	12/06E
Revenues	407,815	593,252	779,292	953,636	1,123,870
Pre-tax profits	260,976	393,365	566,609	683,267	810,281
Net income	207,238	300,211	432,868	529,375	635,157
EPS (UBS, US\$)	1.26	2.72	3.75	4.55	5.44
Net DPS (US\$)	0.19	0.40	0.55	0.60	0.70

Profitability & Valuation	5-yr hist. av.	12/03	12/04E	12/05E	12/06E
ROE %	-	32.7	36.0	32.7	29.8
P/Op x	-	-	-	-	-
P/BVPS x	3.9	1.9	3.0	2.4	2.0
PE (UBS) x	22.0	10.2	13.2	10.9	9.1
Net dividend yield %	0.9	1.4	1.1	1.2	1.4

Source: UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$49.45 on 18 Jan 2005

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 8

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Global Equity Research

United States

Diversified Financial

Rating

Buy 2

Unchanged

Price target

US\$60.00

Unchanged

Price

US\$49.45

RIC: DRL.N BBG: DRL US

18 January 2005

Trading data

52-wk. range	US\$49.25-30.88
Market cap.	US\$5.34bn
Shares o/s	108m
Free float	79%
Avg. daily volume ('000)	368
Avg. daily value (US\$m)	16.5

Balance sheet data 12/04E

Shareholders' equity	US\$1,961bn
P/BV (UBS)	3.0x
Tier one capital ratio	-

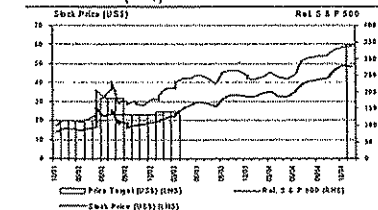
Forecast returns

Forecast price appreciation	+21.3%
Forecast dividend yield	1.2%
Forecast stock return	+22.5%
Market return assumption	8.2%
Forecast excess return	+14.3%

EPS (UBS, US\$)

	12/04E	12/03
	UBS	Cons. Actual
Q1	0.86	0.86 0.40
Q2	0.96	0.96 0.43
Q3	0.97	1.01 0.47
Q4E	1.02	1.04 0.78
12/04E	3.75	3.88
12/05E	4.55	4.54

Performance (US\$)



Source: UBS

www.ubs.com/investmentresearch

Doral Financial 18 January 2005

Doral Reported 4Q04 Earnings of \$1.22, \$0.18 above consensus

After market close today, Doral reported 4th quarter EPS of \$1.22, beating the consensus estimate of \$1.04, and our estimate of \$1.02. Fourth-quarter net income amounted to \$150.5 million, an increase of 59% on a year-over year basis. The company also posted a record high return on assets (ROA) of 3.85% for the year, compared to 3.46% a year ago, and a record return on common equity (ROE) of 38.54% for 2004, compared to 32.36% for the year ended December 31, 2003. This is the 7th consecutive year that the company has achieved record earnings.

After market close today, Doral reported 4th quarter EPS of \$1.22, beating the consensus estimate of \$1.04 and UBS estimate of \$1.02

EPS growth was due to strong fundamentals, still improving credit quality, and a one-time tax benefit from capital gains related to deferred tax assets, in our view.

Loan Production Volume Experienced A Banner Quarter

Loan production volume for the fourth quarter of 2004 was a record \$2.0 billion, compared to \$1.7 billion for the comparable 2003 period, an increase of \$299.2 million or 17%. For the year ended December 31, 2004, loan production volume was \$7.8 billion, compared to \$6.5 billion for the corresponding 2003 period, an increase of 20%. The increase reflected the continued high demand for new housing in Puerto Rico and Doral's strong share of the new housing market, especially in the growing government-sponsored affordable housing loan sector. Many of these mortgage products benefit from local tax exemption on the interest earned thereon. The strength of mortgage loan production helped increase the servicing portfolio to a record \$14.3 billion as of December 31, 2004 from \$12.7 billion as of December 31, 2003. Origination volumes of 20% for the year was achieved despite increasing interest rates during the second half of 2004, a testament to the company's superior customer service.

Loan production volume for the fourth quarter of 2004 was a record \$2.0 billion

Net gain on mortgage loan sales and fees was \$165.8 million for the fourth quarter of 2004 compared to \$116.1 million for the corresponding 2003 period. Net gain on mortgage loan sales and fees was \$598.8 million for the year ended December 31, 2004, compared to \$390.1 million for the corresponding period a year ago. We estimate that gain on sale margins in the fourth quarter was between 750 – 800 bps, still well above our forecast gain on sale margins of 625 bps for 2005.

Origination volumes of 20% for the year was achieved despite increasing interest rates during the second half of 2004, a testament to the company's superior customer service

Solid Credit Quality

Total net charge-offs for the quarter totaled \$0.9, down from \$1.1 million in 3Q 2004, and \$2.0 million in the same quarter a year ago. Credit quality continues to improve due to the continued increase in home prices, and an improving Puerto Rican economy, which is currently experiencing the lowest unemployment rates in the past four years.

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We Believe Net Interest Margin Compression Is Temporary

Net interest income for the fourth quarter of 2004 amounted to \$70.3 million, compared to \$69.9 million in the third quarter of 2004, and \$57.4 million for the same period a year ago, an increase of 2.3% and 23% (annualized), respectively. For the year ended December 31, 2004, net interest income amounted to \$265.9 million, compared to \$181.5 million for the year ended December 31, 2003, an increase of 47%. The increase in net interest income resulted from higher net interest earning assets during the 2004 period.

Net interest margins did drop to 2.17% in fourth quarter 2004 from 2.27% in third quarter 2004 due to increasing interest rates. We note however that the company's cash and money market investments balance grew to \$2.5 billion from \$2.0 billion in the third quarter. This indicates to us that management has not yet started to reinvest cash into higher yielding assets to protect net interest margins. We expect that net interest margins will increase over the next few quarters as management begins to invest cash and money market instruments into higher yielding assets in order to take advantage of higher interest rates.

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Record Earnings Boosted By Tax Benefit

Fourth quarter earnings were significantly boosted by a one time \$77 million tax benefit. We spoke with management about this issue, and understand that the tax benefit the company received was due to a tax code amendment creating an opportunity to accelerate the realization of certain deferred tax assets at reduced long term capital rates. On August 22, 2004, local legislation was enacted to provide a temporary reduction in the long-term capital gain tax rates. The law amends the Puerto Rico Internal Revenue Code of 1994 to reduce the long-term capital gain tax rates by 50% for transactions occurring from July 1, 2004 through June 30, 2005. Excluding this benefit, the Company's effective income tax rate for the fourth quarter ended December 31, 2004 was approximately 18%.

New Tax Law May Create Another Upside Opportunity

The reduction in the long-term capital gain tax rates by 50% will be in place for transactions occurring from July 1, 2004 through June 30, 2005. This gives Doral another six-month window to benefit from utilizing this tax break. We believe that should the company aggressively utilize the tax break, 2005 tax rates may be lower than the 2004 rate of 18%. This could create significant upside potential to our 2005 earnings estimate. Just running our current model at a tax rate of 17% (rather than our 18% assumption) adds \$0.05 to our forecast.

Fourth quarter earnings were significantly boosted by a one time \$77 million tax benefit related to acceleration of deferred long-term capital gains

The reduction in the long-term capital gain tax rates by 50% will be in place for transactions occurring from July 1, 2004 through June 30, 2005

We believe that should the company aggressively continue to utilize the tax break, 2005 tax rates may be lower than the 2004 rate of 18%

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Tax Break Could Have Created Opportunity To Be Conservative In Other Areas

Investment activities for the fourth quarter of 2004 resulted in a loss of \$95.4 million, compared to a loss of \$8.0 million for the fourth quarter of 2003. The loss on investment activities during the fourth quarter of 2004 was principally due to an impairment on the value of the Company's interest-only strips (IOs) of \$97.5 million as a result of increases in the 3-month London Interbank Offered Rate ("LIBOR"), which reduced the anticipated spread of the Company's variable rate IOs.

The \$77.0 million benefit from taxes referred to earlier was an almost perfect offset to a \$97.5 pre tax loss (\$79 after tax) in the fourth quarter from the write-down of interest only strips due to rising interest rates. As laid out in our First Read note earlier today, we had two initial concerns regarding the I/O strip write-down. Specifically,

- Could the write-down be as a result of an issue with the company's hedging program?
- The total value of I/O strips on the balance sheet as at 3rd quarter was \$818 million. Given the large amount of writedowns in 3Q04 (\$61.2 million pre-tax) and 4Q04 (\$97.5 million pre-tax), could there be a potential for negative earnings impact of continued I/O write downs in 2005 as interest rates continue to rise?

This raised some concerns for us initially about the quality of earnings for the fourth quarter. We posed both these questions to management during our conference call, and found that our initial concerns were unwarranted.

I/O Asset Write-down Is Conservative And Could Partially Reverse in 2005

After conversations with management, we now have more confidence that the I/O write-down in the fourth quarter is not related to an issue with the company's hedging program.

We now believe that the I/O write down relates to management taking a conservative approach to valuing its excess servicing asset, given the windfall from taxes experienced during the quarter.

The company's interest-only portfolio of securities had a value of \$818 million at the end of third quarter 2004. This portfolio is made up entirely of excess servicing assets. About 70% of the company's excess servicing assets are floating rate assets, whereby the company pays a variable pass through rate to

The loss on investment activities during the fourth quarter of 2004 was principally due to an impairment on the value of the Company's interest-only strips (IOs) of \$97.5 million

The \$77.0 million benefit from taxes was an almost perfect offset to a \$97.5 pre tax loss (\$79 after tax) in the 4th quarter from the write-down of interest only strips due to rising interest rates

We found that our initial concerns about fourth quarter earnings quality were unwarranted

After conversations with management, we now have more confidence that the I/O write-down in the fourth quarter is not related to an issue with the company's hedging program

We now believe that the I/O write down relates to management taking a conservative approach to valuing its excess servicing asset, given the windfall from taxes experienced during the quarter

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Investors in a pool of mortgage loans with a fixed rate. The present value of the excess spread between the fixed rate on the mortgages (received by Doral from the customer paying the mortgage) and the current LIBOR based pass through rate (paid to investors in the mortgage pool) shrinks during interest rate increases, thus resulting in a decrease in valuation (and subsequent write-off) in floating rate excess servicing assets or floating rate interest only strips.

Doral assesses the fair value of its I/O portfolio every quarter, and gets at least three estimates for the fair value during the assessment period. We believe management went with the most conservative estimates in the fourth quarter of 2004. Thus, even though the excess servicing assets with floating rates could indeed lose value as rates rise in 2005 due to spread compression, we think management has already taken an appropriate charge against these future losses.

We believe that the most conservative assumptions about interest rate increases which could result in a \$97.5 million write down in the current quarter would require the company to expect interest rates to increase significantly in the near future. Thus, as the earnings release states, "If contrary to what is generally expected, LIBOR decreases, a portion of the impairment charges on the value of the IOs could be recovered".

We thus expect that there is potential for a portion of the charge to be recovered if rates do not rise as quickly as anticipated in 2005.

We believe that the most conservative assumptions about interest rate increases which could result in a \$97.5 million write down in I/O strips in the current quarter would require the company to expect interest rates to increase significantly in the near future

We expect that there is potential for a portion of the charge to be recovered if rates do not rise as quickly as anticipated in 2005

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Valuation: Maintaining 2005 EPS of \$4.55, \$60 price target

We are maintaining our 2005 earnings estimate of \$4.55 and 12-month price target of \$60. However, we are now even more comfortable with our target price, given that the potential for upside to our earnings estimates appears even more pronounced. Apart from the potential for upside from moving cash into higher yielding assets and from higher gain on sale margins than the 625 bps we modeled into our 2005 earnings estimate, we believe that fourth quarter 2004 has given plenty of clues as to where else we might expect upside to 2005 earnings, namely:

- Potential for reduced tax rates due to the temporary reduction in long-term capital gain tax rates.
- Potential for some recovery in I/O impairment charges should LIBOR rates not rise as much as anticipated for the purpose of valuing the excess servicing assets or I/O strips.

Our \$60 price target is based on 11x forward PE on our 2006E EPS of \$5.44. We maintain our view that the stock is inexpensive, as it currently trades at a 33% forward PE discount to its U.S peers (a basket of 60 regional banks with market cap between \$1.0 to \$6.0 billion). Even if Doral was valued as a thrift because of its significant residential mortgage business, the current 10.9x forward PE is currently lower than the forward PE of U.S based thrifts such as Golden West (13.4) and Washington Mutual (11.3), yet Doral has demonstrated once again that it can offer superior fundamentals than its U.S counterparts in the banks, as well as thrifts sector.

We are maintaining our 2005 estimate of \$4.55, and price target of \$60.

We are however now even more convinced of our target price, given that the opportunity for upside to our earnings estimate is even more pronounced.

■ Doral Financial

Doral Financial Corp. is a Puerto Rican bank that engages in a wide range of mortgage banking activities, including the origination, purchase, sale and servicing of mortgage loans on single-family residences, and operates bank branches in Puerto Rico and New York City.

■ Statement of Risk

Doral's financial results are sensitive to interest rate fluctuations. Changes in interest rates can materially affect the volume of mortgage originations, net interest income earned, gain on sales, the value of security holdings, and the value of servicing assets and interest only strips.

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Doral Financial's business activities and credit exposure are concentrated in Puerto Rico. Consequently, its financial condition and results of operations are dependent on the economic conditions in Puerto Rico, as well as changes in legislation on the island

■ **Analyst Certification**

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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Required Disclosures

This report has been prepared by UBS Securities LLC, an affiliate of UBS AG (UBS).

UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage ¹	IB services ²
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	Buy 2	FSR is > 10% above the MRA, lower degree of predictability	Buy	36%	32%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	Neutral 2	FSR is between -10% and 10% of the MRA, lower degree of predictability	Hold/Neutral	53%	35%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	Reduce 2	FSR is > 10% below the MRA, lower degree of predictability	Sell	11%	29%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 31 December 2004.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).

Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

Companies mentioned

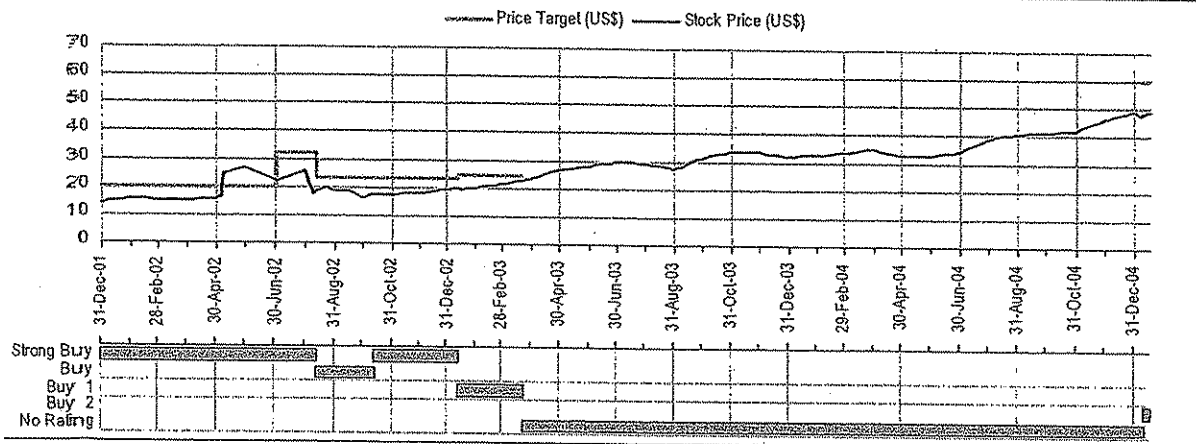
Company Name	Reuters	Rating	Price
Doral Financial ^{2,4,16}	DRL.N	Buy 2	US\$48.95

Price(s) as of 17 January 2005. Source: UBS.

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2. UBS AG, its affiliates or subsidiaries has acted as manager/co-manager in the underwriting or placement of securities of this company or one of its affiliates within the past 12 months.
 4. Within the past three years, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company.
 16. UBS Securities LLC and/or UBS Capital Markets LP makes a market in the securities and/or ADRs of this company.
- Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Doral Financial (US\$)



Source: UBS; as of 17 January 2005.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

Doral Financial 18 January 2005

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GX 1512



UBS Investment Research

Doral Financial

Reiterating Buy 2 Rating : 4Q Results Indicate Even More Upside in 05

■ Stock Oversold Due To Anxiety Over 4Q04 Quality Of Earnings

Although Doral's Q4 EPS of \$1.22 beat consensus by \$0.18, results included a \$77 million tax benefit offset by a \$97.5 million pre tax I/O writedown. We believe the stock sold off 11% today due to concerns about potential for future I/O writedowns, as well as if ineffective hedging from the derivatives book contributed to the writedown.

■ I/O Writedown Due To Conservative Accounting

We believe that the I/O writedown was strictly as a result of management using the tax windfall as an opportunity to conservatively value its I/O strips. We found no evidence that it resulted from an ineffective hedging strategy. We've done the math and believe our theory checks out.

■ Q4 Results Provide 2 New Sources Of Potential Upside in 05

Per management, aggressive use of the temporary tax break (which expires 06/2005) could reduce tax rates to 12% in 2005, creating \$0.30 upside to 2005E EPS. We also believe that the probability of continued large I/O writedowns in '05 is reduced, given the conservative stance taken in Q4 2004.

■ Valuation: Maintaining 2005 EPS of \$4.55, Price Target of \$60

We are maintaining our 2005E EPS of \$4.55 and a price target of \$60. We are now even more comfortable with our earnings estimate, as we believe that the potential for upside is now even more pronounced. Our \$60 price target is based on 11x forward PE on our 2006E EPS of \$5.44

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 9

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Global Equity Research

United States

Diversified Financial

Rating **Buy 2**
Unchanged

Price target **US\$60.00**
Unchanged

Price **US\$44.00**

RIC: DRLN BBG: DRL US

20 January 2005

Trading data

52-wk. range	US\$49.45-30.88
Market cap.	US\$4.75bn
Shares o/s	108m
Free float	79%
Avg. daily volume ('000)	370
Avg. daily value (US\$m)	16.7

Balance sheet data 12/04E

Shareholders' equity	US\$1.961bn
P/BV (UBS)	3.0x
Tier one capital ratio	-

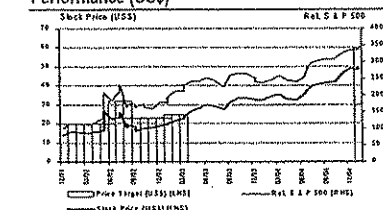
Forecast returns

Forecast price appreciation	+36.4%
Forecast dividend yield	1.2%
Forecast stock return	+37.6%
Market return assumption	8.2%
Forecast excess return	+29.4%

EPS (UBS, US\$)

	12/04E	12/03
	From To Cons. Actual	
Q1	0.86 0.86 0.86	0.40
Q2	0.96 0.96 0.96	0.43
Q3	0.97 0.97 1.01	0.47
Q4E	1.02 1.02 1.22	0.78
12/04E	3.75 3.75 4.05	
12/05E	4.55 4.59 4.54	

Performance (US\$)



Source: UBS

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Doral Financial 20 January 2005

We Reiterate Our Buy 2 Rating

After reporting fourth quarter earnings of \$1.22 (\$0.18 above consensus) after market close of January 18th, 2004, Doral's stock experienced an 11% drop in value and 18x increase in daily trading volume during trading hours on January 19th, 2004. We believe the significant sell-off was due to concerns about two large lumpy items in fourth quarter earnings.

- A \$77 million tax benefit due to a temporary 50% reduction in long-term capital gains rates in Puerto Rico.
- A \$97.5 pretax write-down of the interest only (I/O) portfolio

We believe the interest-only portfolio write-down in particular could have created concerns that the company may have had an issue with its derivative book not properly hedging the interest only portfolio in the fourth quarter, and that there could be potential for more I/O writedowns in 2005 as LIBOR rates rise.

We Believe The Stock Is Oversold

We spoke to management at length over the past two days about these concerns, as well as did some independent analysis to get comfortable that concerns about these issues (which are reflected in the stock's 11% drop in value) are overblown. Based on our analysis, we believe that there is some misunderstanding in the market about the nature of the lumpy items in fourth quarter earnings, and believe that :

- (1) The write-down of interest only strips during the quarter had nothing to do with an ineffective derivative matching strategy.
- (2) The company could potentially benefit from a reversal in the valuation of the I/O strips in 2005, as well as an even lower tax environment due to the temporary 50% reduction in long-term capital gains rates in Puerto Rico.

We thus believe that the recent sell-off in Doral stock creates an attractive buying opportunity for a stock that otherwise exhibits very strong fundamentals, and which has several EPS upside opportunities in 2005.

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We Believe The Stock Is Oversold

Doral Financial 20 January 2005

Noisy Q4 Result Created Anxiety Over Quality Of Earnings

Although Doral's Q4 EPS of \$1.22 beat street consensus by \$0.18, results included a \$77 million tax benefit offset by a \$97.5 million pre tax I/O write-down. We find it interesting that that \$77.0 million benefit from taxes was an almost perfect offset to a \$97.5 pre tax loss (\$79 after tax) in the fourth quarter from the write-down of interest only strips due to rising interest rates. This indicated to us that management might have used the windfall on the tax benefit to be a bit more conservative in the valuation of the interest only strips.

However, we did have two initial concerns regarding the I/O strip write-down. Specifically,

- Could the write-down be as a result of an issue with the company's hedging program?
- The total value of I/O strips on the balance sheet as at 3rd quarter was \$818 million. Given the large amount of writedowns in 3Q04 (\$61.2 million pre-tax) and 4Q04 (\$97.5 million pre-tax), could there be a potential for negative earnings impact of continued I/O write downs in 2005 as interest rates continue to rise?

This raised some concerns for us initially about the quality of earnings for the fourth quarter, which we believe was echoed on the street by some analysts. We however posed both these questions to management during conference calls on the 18th and 19th of January, and found that our initial concerns were unwarranted.

We found that our initial concerns about fourth quarter earnings quality were unwarranted.

We Found No Evidence That The Loss In The Trading Accounts Is Related To An Ineffective Hedging Strategy in Q4 2004

Doral reports all changes in its derivative books and other trading securities in the trading activities line item of the income statement. We note that the total loss from trading activities for the quarter was \$95.4 million. Excluding the \$97.5 million loss from the I/O write-down, this results in \$2.1 million gain in the trading account. We believe that this gain is related to the derivatives book. We note that the loss position of other comprehensive income on the balance sheet increased by \$8.0 million in the fourth quarter, and thus believe the derivatives book did a fair job of hedging the company against an \$8.0 million loss (mainly from decreases in value of the securities portfolio due to rising rates) had the company decided to realize the loss this quarter by selling some of its securities portfolio, and reinvesting the proceeds in higher yield investment securities.

We found no evidence that the Loss in the trading accounts is related an ineffective hedging strategy

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I/O Write-down Due To Conservative Accounting

Based on our belief that the derivatives book did eke out a slight gain in Q4 2004, we believe that the \$97.5 million I/O write-down that is lumped in with derivative gains and losses in the company's trading securities portfolio for reporting purposes is an entirely separate issue. We believe that the I/O write down has nothing to do with concerns some investors have expressed in regards to the derivatives book not properly offsetting losses on the I/O strip as LIBOR rates continued rising in the second half of 2004.

We believe the write-down truly is as a result of management using the \$77 million tax windfall as an opportunity to conservatively value its I/O strips. The company's interest-only portfolio of securities has a value of \$869 million at the end of fourth quarter 2004. This portfolio is made up entirely of excess servicing assets. Per management, about 60-70% of the company's excess servicing assets are floating rate assets, whereby the company pays a variable pass through rate to investors in a pool of mortgage loans with a fixed rate. The present value of the excess spread between the fixed rate on the mortgages (received by Doral from the customer paying the mortgage) and the current LIBOR based pass through rate (paid to investors in the mortgage pool) shrinks during interest rate increases, thus resulting in a decrease in valuation (and subsequent write-off) in floating rate excess servicing assets or floating rate interest only strips.

Doral assesses the fair value of its I/O portfolio every quarter, and gets at least three estimates for the fair value of these estimates during the assessment period. We believe management went with the most conservative estimates in the fourth quarter of 2004. We believe the most conservative of the estimates was a result of the company making an assumption that 90 day LIBOR rates utilized in their I/O valuation model would be more in-line with expectations of most economists (around 4.0%), rather than at the low end of expectations (around 3.5%). We believe this increase in expected LIBOR rates in the company's I/O valuation model created the \$97.5 million. Here is our logic

1. We created a simple I/O valuation model using prepayment and discount rate assumptions previously disclosed by the company in their 2003 10-K, as well as a 3.5% expected LIBOR rate, which we believe is in the ball park of management's previous assumptions about a forecasted LIBOR rate for 2005 year end.
2. We made an assumption that the current yield on the non-conventional loans, which creates these I/O strips, increases to about 8.5% in 2005, from about 7.5% in 2004, as rates continue to rise.

We believe the write-down truly is as a result of management using the \$77 million tax windfall as an opportunity to conservatively value its I/O strips.

We believe a change in management's assumptions about 90 day LIBOR rates created the I/O write-down

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3. Based on management guidance, we assumed that the typical pass through rate of most variable rate I/O's is LIBOR + 200 bps. Using the 8.5% assumed yield on the underlying nonconventional loans, this results in a spread of 650 bps - LIBOR for I/O valuation purposes.
4. We assumed that loan growth rate for nonconventional loans, which generate these I/O strips, would approximate our 2005 expectations of mortgage origination growth slowing to 12% due to increasing interest rates.
5. We then increased the LIBOR rate from 3.5% to 4.0% in our model.
6. Discounting the expected value of interest only strips that are originated over the next seven years (the weighted average life of the underlying mortgage loans according to 2003 10K disclosures), our model indicated a loss in value of about \$105 million on the variable rate I/O strips by raising expectations for LIBOR rates from 3.5% to 4.0%. Our \$105 million estimated loss in valuation is not too far off from the \$97.5 million reported by Doral during the fourth quarter.

Chart 1: Interest Only Strip Valuation Scenario Model - (\$000)

Discount Rate	8.25%						
Prepayment Rate	10.25%						
Est Non Conventional Mortgage Loan Yield	8.50%						
Other Assumptions							
Loan Growth	12.00%						
3 Month LIBOR Forecast	4.00%						
	2005	2006	2007	2008	2009	2010	2011
Beginning Balance	4,000,000	4,020,800	4,041,708	4,062,725	4,083,851	4,105,087	4,126,434
Loan Growth	480,000	482,496	485,005	487,527	490,062	492,610	495,172
Prepayment	459,200	461,588	463,988	466,401	468,826	471,264	473,715
Ending Balance	4,020,800	4,041,708	4,062,725	4,083,851	4,105,087	4,126,434	4,147,891
Estimated Yield	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
Estimated Pass Through	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
Spread	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Discount Rate	1.0825	1.17180625	1.268480266	1.373129688	1.486413103	1.60904218	1.741788164
I/O value	92,859	85,228	80,071	74,353	69,044	64,113	59,535
Total Variable I/O Balance - LIBOR @ 4%	526,203						
Total I/O Balance	869,000						
Variable I/O (As Percentage of Total)	60.55%						
Total Variable I/O Balance- LIBOR @ 3.5%	631,443						
VALUATION DIFFERENCE		105,240					

Source: UBS, Company Reports

Given our analysis, we believe that the most conservative assumptions about interest rate increases which would result in a \$97.5 million write down in the current quarter would require Doral management to expect 90 day LIBOR rates to increase to about 4.0% by year end. Given that there are some economic forecasts for 90-day LIBOR to be less than 4.0% by the end of 2005, we thus reiterate the following statement which we found interesting in the company's earnings release statement - "If contrary to what is generally expected, LIBOR decreases, a portion of the impairment charges on the value of the IOs could be recovered".

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Given the above statement, we thus expect that there is potential for a portion of the I/O write-down to be recovered if rates do not rise as quickly as anticipated in 2005.

New Derivative Positions Also Provide Some Comfort About Future I/O Writedowns

While we believe that the potential for any large future writedowns in the I/O strips in 2005 is significantly reduced due to the conservative stance management took in 4Q 2004, we nonetheless asked management if a write-down of the kind of magnitude seen in the fourth quarter was possible going forward.

We learned that management increased its derivative books in the fourth quarter by buying Eurodollar options to hedge against any potential increase in LIBOR rates in 2005. The notional amount for this hedge is about \$4 billion, roughly the size of the current non-conventional loan portfolio that generated the \$869 million in interest only strips currently on the company's books. We believe that should the options serve as a perfect hedge for the I/O strips, that the maximum loss that the company can expect from I/O strips in 2005 would be the premium paid for the Eurodollar options (about \$15 million according to management).

We thus feel more comfortable with the notion that management has adequately protected the interest only strips from major swings in valuation in 2005.

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We thus feel more comfortable with the notion that management has adequately protected the interest only strips from major swings in valuation in 2005.

Potential For Impact To Gain On Sale Margins, But We See No Earnings Risk in 2005.

Given the more conservative approach to valuing the I/O strip, we believe that gain on sale margins for Doral could face some compression going forward. This is because the conservative valuation of the I/O strips should result in a higher book value being attributed to mortgage loans during the securitization process. We do not expect that this potential margin compression would have an impact on our 2005 earnings estimates, given that we are estimating a 625 bps gain on sale margin in 2005, and believe that the current gain on sale margins for the company is closer to 750 bps.

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Q4 2004 Results Provide Two New Sources Of Potential Upside in 2005

The reduction in the long-term capital gain tax rates by fifty percent will be in place for transactions occurring from July 1, 2004 through June 30, 2005. This gives Doral another six-month window to benefit from utilizing this tax break. We believe that should the company aggressively utilize the tax break, that 2005 tax rates may be lower than the 2004 rate of 18%. This could create significant upside to our 2005 earnings estimate. We note that running our current model at a tax rate of 17% (rather than our 18% assumption) creates \$0.05 upside.

From our conversation this morning, management provided more color in regards to the potential benefit of the capital gains tax break in 2005. Per management, aggressive utilization the tax break could reduce 2005 taxes by about \$36 million, which would reduce tax rates to 12%, and create \$0.30 upside to 2005E EPS. While we do not expect management to be this aggressive, we do believe that the company's tax rate in 2005 will enjoy some material benefits from the 50% reduction in long-term capital gains, leading to earnings upside for the year.

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Valuation: Maintaining 2005 EPS of \$4.55, Price Target of \$60

We are maintaining our 2005 estimate of \$4.55, and price target of \$60. We are however now even more comfortable with our earnings estimate, given our belief that the opportunity for upside to our earnings estimate is even more pronounced. Apart from the potential for upside from moving cash into higher yielding assets and also upside from higher gain on sale margins than the 625 bps we modeled into our 2005 earnings estimate, we believe that fourth quarter 2004 has given two new clues as to where else we could expect upside to 2005 earnings namely:

- Potential for reduced tax rates due to the temporary reduction in the long-term capital gain tax rates.
- Potential for some recovery in I/O impairment charges should LIBOR rates not rise as much as anticipated for the purpose of valuing the excess servicing assets or I/O strips.

Our \$60 price target is based on an 11x forward PE on our 2006E EPS of \$5.44. We continue to maintain that the stock is undervalued, as it currently trades at 39% forward PE discount to its U.S peers (a basket of 60 regional banks with market cap between \$1.0 to \$6.0 billion). This is versus a 29% historical forward PE discount.

Even if Doral was valued as a thrift because of its significant residential mortgage business, the current 9.7x forward PE (after the sell-off on January 19th) is significantly lower than the forward PE of U.S based thrifts such as Golden West (13.4) and Washington Mutual (11.3), yet Doral has demonstrated once again this quarter that it has superior fundamentals than its U.S counterparts in the banks, as well as thrifts sector.

We note that despite the noisy quarter, we note the following stellar operating metrics

- Doral did report fourth quarter EPS of \$1.22, handily beating consensus estimates of \$1.04, and UBS estimates of \$1.02.
- 4th quarter net income amounted to \$150.5 million, an increase of 59% on a year-over year basis.
- The company also posted a record high return on assets (ROA) of 3.85% for the year, compared to 3.46% a year ago, and a record return on common equity (ROE) of 38.54% for 2004, compared to 32.36% for the year ended December 31, 2003.

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- Loan production volume for the fourth quarter of 2004 was a record \$2.0 billion, compared to \$1.7 billion for the comparable 2003 period, an increase of \$299.2 million or 17%. For the year ended December 31, 2004, loan production volume was \$7.8 billion, compared to \$6.5 billion for the corresponding 2003 period, an increase of 20%. Origination volumes of 20% for the year was achieved despite increasing interest rates during the second half of 2004, a testament to the company's superior customer service.
- Total net charge-offs for the quarter totaled \$0.9, down from \$1.1 million in 3Q 2004, and \$2.0 million in the same quarter a year ago. Credit quality continues to improve due to the continued increase in home prices, and an improving Puerto Rican economy, which is currently experiencing the lowest unemployment rates in the past four years.

■ Doral Financial

Doral Financial Corp. is a Puerto Rican bank that engages in a wide range of mortgage banking activities, including the origination, purchase, sale and servicing of mortgage loans on single-family residences, and operates bank branches in Puerto Rico and New York City.

■ Statement of Risk

Doral's financial results are sensitive to interest rate fluctuations. Changes in interest rates can materially affect the volume of mortgage originations, net interest income earned, gain on sales, the value of security holdings, and the value of servicing assets and interest only strips.

Doral Financial's business activities and credit exposure are concentrated in Puerto Rico. Consequently, its financial condition and results of operations are dependent on the economic conditions in Puerto Rico, as well as changes in legislation on the island.

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Doral Financial 20 January 2005

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UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage ¹	IB services ²
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	Buy 2	FSR is > 10% above the MRA, lower degree of predictability	Buy	36%	32%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	Neutral 2	FSR is between -10% and 10% of the MRA, lower degree of predictability	Hold/Neutral	53%	35%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	Reduce 2	FSR is > 10% below the MRA, lower degree of predictability	Sell	11%	29%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 31 December 2004.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).

Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

Companies mentioned

Company Name	Reuters	Rating	Price
Doral Financial ^{2,4,16}	DRL.N	Buy 2	US\$49.45
Golden West Finance ¹⁶	GDW.N	Neutral 1 (RRD)	US\$61.63
Washington Mutual ^{2,6a,6b,7,16}	WM.N	Neutral 2	US\$41.61

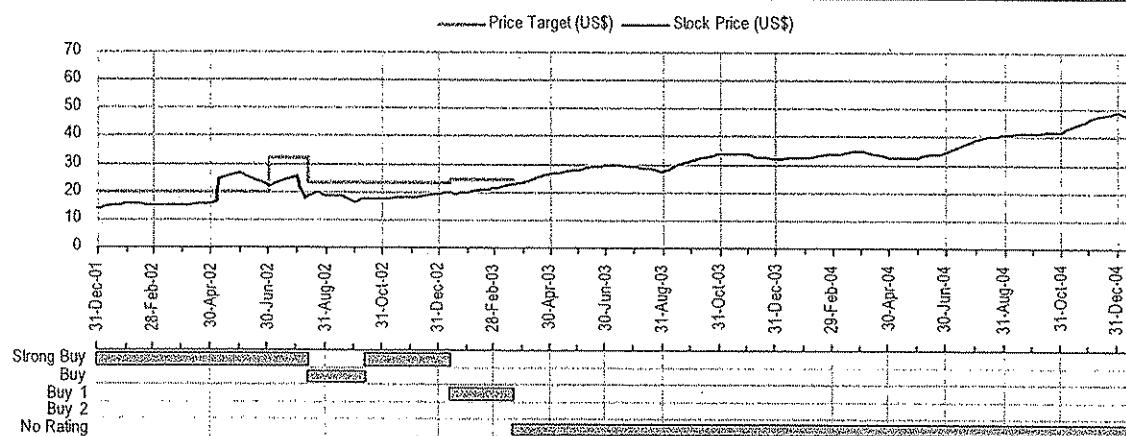
Doral Financial 20 January 2005

Price(s) as of 18 January 2005. Source: UBS.

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Doral Financial (US\$)



Source: UBS; as of 18 January 2005.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

Doral Financial 20 January 2005

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GX 1514

Okusanya, Omotayo

From: Sammy Levis [Sammy.Levis@doralfinancial.com]
Sent: Tuesday, February 15, 2005 8:33 AM
To: Okusanya, Omotayo
Subject: Re: Servicing Fee Question

Tayo: In non-conforming loans, we charge .25 servicing fee while in FHA/VA (GNMA) we charge .44 basis points. In FNMA/FHLMC conforming we also charge .25. There have been instances in the past that for both non-conforming and conforming, we have charged .375, but this is the exception rather than the rule. Regarding caps, they are all over. But a typical cap is around 250 basis points above the initial variable net yield paid to investors. In all events, these caps are significantly lower than the WAC of the loans. So at all times, Doral will enjoy a hefty positive spread.

-----Original Message-----

From: Omotayo.Okusanya@ubs.com <Omotayo.Okusanya@ubs.com>
To: Sammy Levis <Sammy.Levis@doralfinancial.com>
Sent: Tue Feb 15 09:00:21 2005
Subject: Servicing Fee Question

Sammy,

Good morning. I am still working on my report and just had two follow up questions:

1. Could you let me know what the typical service fee is on the nonconforming loan? do you charge fees close to the 44 bps charged on GNMA loans, or is the service fee higher for these loans?
2. What is a typical cap on the pass through rate for the nonconforming loans sold to the other commercial banks?

Thanks again for your help.

Regards,

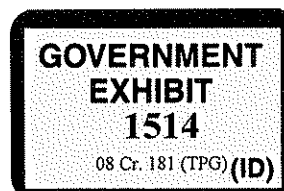
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GX 1523

αβ

Global Equity Research

Americas

Diversified Financial

Rating

Suspended

Price target

Price US\$22.55

RIC: DRLN BBG: DRL US

23 March 2005

Trading data

52-wk. range	US\$49.45-21.5
Market cap.	US\$2.43b
Shares o/s	108r
Free float	79%
Avg. daily volume ('000)	1,75
Avg. daily value (US\$m)	60.

Balance sheet data 12/04E

Shareholders' equity

P/BV (UBS)

Tier one capital ratio

Forecast returns

Forecast price appreciation

Forecast dividend yield

Forecast stock return

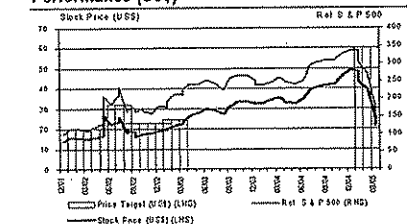
Market return assumption 8.8%

Forecast excess return

EPS (UBS, US\$)

	12/04E	12/0
	UBS	Cons. Actua
Q1	0.86	0.86 0.4
Q2	0.96	0.96 0.4
Q3	0.97	1.01 0.4
Q4E	1.22	1.22 0.7
12/04E	3.95	4.05
12/05E	4.55	3.68

Performance (US\$)



Source: UBS

www.ubs.com/investmentresearch

UBS Investment Research

Doral Financial

After The Storm: "Cash Based" EPS Indicates Attractive Valuation

■ Current valuation attractive; I/O strips do have some value.

If zero value is given to noncash gains/losses from Doral's I/O strips, MSR's and related hedges, "cash based" EPS in '05 and '06 would be \$2.38 and \$2.83 respectively. This implies a current stock price of \$25 using a historic 10.5 P/E. Our prior research indicates that Doral's I/O strips do have some value, implying future upside.

■ 2004 10-K reveals increased business risks

We believe DRL's stock recently sold off sharply due to concerns about 1) sustainability of I/O assumptions 2) interest rate sensitivity 3) slowing loan origination 4) underhedging of the I/O strips and 5) -ve EPS impact from new local tax legislation. Conversations with management indicate they are taking steps to address these issues, including possible sale of the I/O strips.

■ Successful hedging program key to managing earnings downside

We believe the key to managing increased I/O and interest risk exposure at Doral will be a successful hedging program. We believe Doral was underhedged in 2004, and expect \$75- \$100m in charges as the company adjusts its hedging positions.

■ Valuation: Maintain Buy 2 rating; \$30 12-month price target

Our new price target is based on a historical 10.5 P/E on cash-based 2006E EPS of \$2.83. We believe Doral can grow annual cash-based EPS by 10+% in '05 and '06 due to our expectations of continued strength in the Puerto

Highlights (US\$m)	12/02	12/03	12/04E	12/05E
Revenues	407,815	593,252	716,282	941,045
Pre-tax profits	260,976	393,365	501,723	660,887
Net income	207,238	300,211	456,325	528,454
EPS (UBS, US\$)	1.26	2.72	3.95	4.55
Net DPS (US\$)	0.19	0.40	0.55	0.60

Profitability & Valuation	5-yr hist. av.	12/03	12/04E	12/05E
ROE %	-	32.7	37.7	32.4
P/Op x	-	-	-	-
P/BVPS x	3.9	1.9	1.4	1.1
PE (UBS) x	22.0	10.2	5.7	5.0
Net dividend yield %	0.9	1.4	2.4	2.7

Source: Company accounts, Thomson Financial, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items of the analysts' judgement.

Valuations: based on an average share price that year. (E): based on a share price of US\$22.55 on 22 Mar 2005 19:36 EST

Omotayo Okusanya, II, CFA

omotayo.okusanya@ubs.com

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 18

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Maintain Buy 2 Rating, But Reducing Price Target To \$30

Doral released its eagerly awaited 10-K report after market close on March 15th, 2005. We applaud the company for the improvement in overall disclosures, but believe that the new disclosures raised several new questions about the company's business model. Unfortunately, we do not believe the conference call held on March 17th helped alleviate investor concerns. As a result, the stock has lost about 45% of its value since the release of the 10-K. We believe that the main investor concerns about the company are 1) the sustainability of I/O assumptions 2) potential for more I/O write-downs; 3) overall interest rate sensitivity 4) slowing loan origination; and 5) potential negative EPS impact from new local tax legislation

Current stock price gives no value to interest only strips

We believe that Doral's stock should be trading close to \$25, based on Doral's cash based EPS. By cash based EPS, we mean Doral's reported EPS excluding all non-cash gains/losses from I/O strips, mortgage-servicing rights (MSRs) and related hedges. Cash based EPS ensures that no value is accorded the large gain on sales margins recorded by the company due to the large valuations for its I/O strips. From our calculations, Doral's cash based EPS in '04, '05 and '06 would be \$2.20, \$2.38 and \$2.83 respectively. Our expectations of a \$25 current stock price is based on Doral's historic 10.5 forward PE on 2005 cash based EPS of \$2.38.

From our report issued on March 9th, 2005 entitled "*After Digging Into Issue , Reiterating our Buy 2 Rating*", we showed that Doral's I/O valuations as at 3Q04 could probably be supported in the MBS market, once adjustments are made for the lower prepayment speed generally experienced in Puerto Rico, and a lower discount rate due to the solid credit quality of mortgage loans on the island. We therefore believe that the company's gain on sale business model does have some value. The current confusion in the market is how much value to accord to this business model. We expect that the market will continue to give zero value to Doral's gain on sale business model until management can provide clear evidence that the company's I/O strips are fairly valued. We believe management can only achieve this by 1) providing more transparency into the assumptions used internally by the company to value its I/O strips 2) providing transparency into the external valuations done by independent third parties on the I/O strips or 3) selling some or all of the I/O strips in the MBS market to establish a market price.

Until more transparency is available into the company's I/O valuation (which will determine gain on sale margins going forward), we are valuing Doral based on our cash based EPS model. Our \$30 12- month target price is based on historical 10.5x forward EPS on 2006E cash based EPS of \$2.83. We maintain

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Doral Financial

our Buy 2 Rating. We believe that one of the key factors to significant share appreciation will be management's ability to restore investor confidence in its business. The other potential overhang on Doral's stock would be concerns about regulatory actions should the I/O strips be deemed as overvalued due to unsustainable valuation assumptions, even if such assumptions may have been made in good faith. We expect the process of restoring investor credibility will be a gradual process and will require a significant improvement in investor relations at Doral. However, given our belief that the market is currently undervaluing Doral's gain on sale business model (specifically the I/O strips), we believe the potential for significant upside makes Doral's stock an attractive holding at current prices. In addition, at current prices, the stock is offering an attractive 3% dividend yield.

Potential Positive Catalysts

Given current market sentiment about Doral's gain on sale business model, we believe that key catalysts for the stock would include more transparency on the I/O valuation assumptions, better guidance from management on 2005 earnings, and a signal from management that the stock may currently be undervalued. We met with management on March 29th, and believe that management is actively considering the following plans of action:

A sale of some portion of the I/O portfolio: Such a sale would serve as a clear indication that the I/O strips have value in the MBS market.

More transparency on I/O valuation methodologies: We believe management is looking into providing more detail on the I/O valuation assumptions used by the company in their internal valuation model, as well as valuations provided by external parties. We believe more transparency would go a long way to show that the I/O strips do have value.

Initiating a stock repurchase program: We believe that management is taking this suggestion more seriously in light of the recent sell-off. We note that management currently has a 20% stake in the company.

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Doral Financial

Chart 1: "Cash Based" EPS Analysis

	2004	2005	2006
Net Interest Income	265898	304467	399098
Less Income From I/O	55568	57642	64759
"Cash Based" Net Interest Income	210330	246825	334339
Non-Interest income	450384	541072	652596
Less Gain On Sale	598762	534945	582263
Less Hedging Related Losses	200607	53947	1875
Less MSR Income	4893	11353	17088
"Cash Based" Non Interest Income	47336	48722	55120
Nonconforming Loans - Beginning Balance	4624000	7000000	9308342
Nonconforming Loans - Ending Balance	7000000	9308342	11266244
Nonconforming Loans - Average Balance	5812000	8154171	10287293
Expected Avg LIBOR Rate	1.85%	3.28%	4.00%
Expected WAC	7.5%	7.86%	8.12%
Spread on nonconforming loan sale	4.65%	3.58%	3.22%
Income from nonconforming loan sales	270258	291546	330888
Total revenue	527924	587092	720347
Operating Expenses	209052	251601	316232
Pre-Tax Earnings	318872	335492	404115
Tax rate	17.5%	15.0%	16.0%
After Tax Earnings	263071	285168	339457
Cash Based EPS	\$ 2.20	\$ 2.38	\$ 2.83

Source: UBS

2004 10-K Review

Increased Business Risks Exposed in 10-K

Following our review of the 2004 10-K and subsequent conference call held by management on March 17th, we believe that the main areas of concern regarding Doral's business are as follows:

Sustainability of I/O assumptions;

Potential for more I/O write-downs;

Interest rate sensitivity;

Slowing loan origination; and

Potential negative EPS impact from new local tax legislation.

Sustainability of I/O Assumptions

Valuation Assumptions Even Lower in Q404

Doral once again reduced the value of key assumptions used to calculate the value of its I/O strips. Specifically,

The prepayment speed assumption was reduced to 7.20% in 4Q04, from 10.5% in 3Q04.

The discount rate was reduced to 7.6% in 4Q04, from 8.25% in 3Q04.

Lower Assumptions in 4Q04 Not Unique To Doral

The reduction in these two assumptions increases Doral's I/O valuations, which further heightened investor concern about Doral's I/O valuation. However, we offer the following points of reference as to why these changes in assumptions could be warranted.

As a result of rising rates, actual prepayment speeds experienced by the underlying principal balances that support I/O valuations in the MBS market did decline between Q3 and Q4 2004. We calculated average prepayment speed of a sample of traded I/O strips in Q304 and Q404, and found prepayment speeds came down on average by 16%.

Doral Financial

Chart 2: Average Prepayment Speed for I/O Strips 3Q04 vs. 4Q04

I/O Strip	Average Prepayment Speed - 3Q04	Average Prepayment Speed 4Q04	Increase/ (Decrease) in Prepayment Speeds
FNS 222	35.06	24.92	-29%
FHS 205	42.1	38.0	-10%
FNS 240	35.64	26.9	-25%
FHS 177	35.64	31.64	-11%
FNS 320	44.66	42.2	-6%
FHS 221	45.22	37.42	-17%
Average			-16%
Doral	10.5	7.20	-31%

Source: Bloomberg

We looked through the 2004 10-K disclosure of other banks that are involved in loan securitization, and found that there was downward revision in prepayment speed and discount rate assumptions, which should also have increased I/O valuations at these banks in 2004.

Chart 3: Assumptions Used To value Residual Interests : 2004 vs. 2003

	2003 Discount Rate	2004 Discount Rate	2003 Prepayment Rate	2004 Prepayment Rate	Comments
Bank of America	15 - 30%	15-30%	8 - 42%	7.5-32.7%	(a)
Wells Fargo	12%	10%	18%	15%	(b)
Washington Mutual	3% - 6%	4.30%	42 - 51%	30.50%	
Countrywide	20%	18%	31%	33%	
Wachovia	11%	11%	45%	41%	
SunTrust	10%	10%	16%	15%	
Cendant Mortgage Corp	5 - 15%	7%	7% - 25%	10-24%	
Doral Financial	9%	8%	18%	7%	

Source: Company reports

Comments: (a) For entire commercial finance portfolio (ex credit cards) (b) Aggregate for residential mortgage, commercial real estate, student loan, and autos.

Management Efforts To Lower Prepayment Speeds Likely A Contributing Factor

Although banks generally lowered prepayment speed and discount rate assumptions in 2004 versus 2003, the change in I/O valuation assumptions does appear high at Doral. We estimate that Doral would have had to take an additional \$60 million I/O writedown in Q404 if management had maintained Q304 prepayment speed and discount rate assumptions at year-end. This would have reduced gain on sale margins to about 650 bps in 2004, from our estimate of roughly 750 bps.

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We believe the following statement in the 10-K provides some insight into why assumptions had a more significant change at Doral than at U.S. banks.

“The difference in prepayment speeds (for MSR valuation versus I/O valuation) is primarily due to prepayment penalties associated exclusively to non-conforming loans (the sale of which generate the I/O strips). Other activities that help reduce prepayments for nonconforming loans include the adoption of special internal measures such as loan modifications that reduce borrowers’ monthly payments by extending the terms of the loans and granting second mortgages in lieu of refinancing cash-outs”.

From the above statement, it appears to us that management has been actively trying to reduce prepayment risk on non-conforming loans in 2004, and that these initiatives could have resulted in prepayment speeds coming down even faster at Doral than at other banks. We note that prepayment penalties at Doral tend to be much more stringent than in the United States which could also be contributing to the lower prepayment speed. For example, nonconforming loans are not allowed to prepay for the first five years. This is versus a 2-3 year lockout period in the United States. At Doral, prepayment penalties are also as high as 5% of the outstanding loan balance, versus in the U.S. where the penalty is typically 1-2% of the outstanding loan balance.

Current Practices Increases Business Risk, And May Be Unsustainable Long Term, Given Increasing Competition

Although Doral’s current business practices may lower prepayment speeds and increase I/O valuations, it does increase some other business risks, which may be unquantifiable, but are indeed real.

Modifying contract terms to extend the life of the mortgage increases the duration of fixed rate assets, and results in the balance sheet being more liability sensitive. This increases interest rate risk.

Extension of the life of the nonconforming loan also results in larger outstanding balances at any given point in time. This increases credit risk if the loan should default.

We believe that Doral’s strategy to reduce prepayment speed is probably sustainable in the near-term, given that the company has about 60% market share in the nonconforming loan origination market. We however recently learned that two local banks (First Bancorp and BBVA) entered the mortgage market in the past six months. We believe that the total market share of these two new entrants is less than 2%. These two new entrants could try to compete on price to gain market share, which could negatively impact Doral’s gain on sale margins, prepayment speeds and loan origination growth in the long-term.

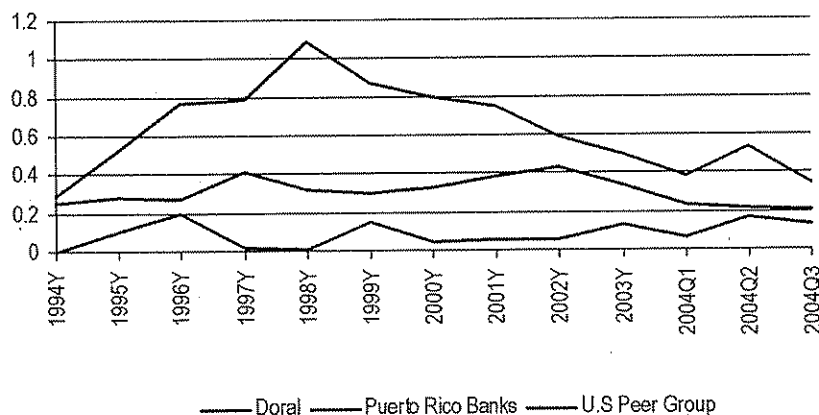
UBS 7

We Do Not Believe Doral Will Be Another "Gain On Sale Gone Bust" Story

Doral has been strengthening its underwriting requirements. These nonconforming loans, which generate the company's I/O strips, have low balances (typically \$60,000 to \$80,000), a loan to value ratio of 60 – 70%, with the mortgage holder having an average FICO score of 680. We do not see any evidence that there has been a movement towards sub prime lending in order to generate larger gain on sale margins, and in fact note that charge-off ratios at Doral have actually been improving over the past decade. We mention the above point to address concerns about if Doral has been increasing gain on sale margins by taking on higher risk, higher interest, but lower credit quality loans.

We are comfortable with the notion that credit quality is not being sacrificed for increasing gain on sale margins, and that Doral's business is not built on the same flawed premise as other failed mortgage originators such as Superior Bank and Keystone Bank, both of which had high gain on sale margins, but ultimately collapsed once interest rates rose and credit subsequently worsened in their large subprime businesses.

Chart 4: Net Charge-Off Rates: Doral Vs. Local and U.S Peer Groups



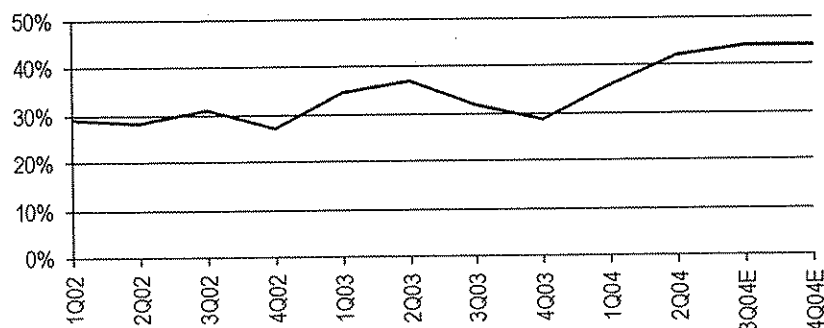
Source: SNL. U.S Peer Group used is 60 regional banks and thrifts with market caps between \$1 - \$6 billion.

We note that although I/O strips as a percentage of Doral's shareholder equity is at a company high of 42%, it is still at manageable levels compared to Superior Bank, which maintained a ratio greater than 100% since it began to grow its mortgage business in 1995, and eventually collapsed in 2001 with a ratio of 2,042%. We mention this point because I/O strips typically bear first loss risk in securitization transactions. In simple terms, a total I/O to total shareholder's equity ratio in excess of 100% means that while equity holders agree to absorb first risk loss of \$1 by investing in a bank, the bank itself is on the hook for a first loss risk greater than \$1 through the securitization. We currently are not overly concerned that Doral may be taking on too much risk

Doral Financial

through its loan securitizations, especially given strong asset quality levels within the mortgage market in Puerto Rico.

Chart 5: Doral - I/O Strips As A Percentage Of Shareholder's Equity



Source: Company reports

Potential For More I/O Write-downs

Doral disclosed in its 10-K that a 25 bps increase in LIBOR rates would cause a \$69 million impairment to its I/O strips, and that a 200 bps increase in LIBOR would cause a \$542 million impairment.

Chart 6: Impact of rising rates on I/O valuations

Increase in 3-month LIBOR (basis points)	25	50	100	200
Change in Fair Value of IO Strips (\$ mil)	-70	-139	-275	-542

Source: Company reports

These amounts are significantly above our expectations as at 3Q04, and are also a significant contributor to investor anxiety about the company's I/O strips.

We believe that the following statement from the 10-K provides insight into why the potential for I/O write-downs are much larger than we previously anticipated.

"Generally, the loans sold (which generates the I/O strips) are subject to interest rate caps set at or below the weighted-average coupon (less the servicing fee) on the pools of loans and to a lesser extent based on a spread above the initial contractual pass-through rate at the time of sale, which does not exceed the weighted-average coupon (WAC) on the loans".

It thus appears that most of the caps on the spread earned from the sale of nonconforming loans are set closer to the WAC (or average mortgage rate) on

Doral Financial

the loans underlying the I/O strips, rather than a spread above the initial contractual pass-through rate at the time of sale (typically around 250 bps). This has the effect of not fully protecting the company's I/O strips from impairment until LIBOR rates are closer to about 7.0%, rather than our previous estimate of 4.0%. Our previous estimate was based on a 250 bps spread above our estimate of the average LIBOR rate at which most of the nonconforming loans underlying the I/O strips were originated. For more details, please refer to our report from March 9th, 2005 entitled "*After Digging Into Issues, Reiterating our Buy 2 Rating*".

We believe that management has realized the potential exposure the I/O strips have to continued increases in LIBOR. We estimate that the company needs to be long put options on about \$26 million in notional value of Eurodollar deposits to be properly hedged against continued writedowns of \$878 million in I/O strips as at Q4 2004. Per management, put options on over \$25 million in notional value of Eurodollar deposits was added in 1Q 2005 to hedge the I/O strips. We estimate that the total value of I/O strips however grew another \$50 million in Q1 2005, and that Doral may experience about \$75- \$100 million in I/O related charges in 2005 as it continues to attempt to properly hedge its I/O strips. We expect that some of this charge will be partially offset by some success in hedging this risk.

Interest Rate Sensitivity

Doral More Liability Sensitive In 4Q04

Another major change we noted in the 2004 10-K is the bank's new interest rate sensitivity disclosure. Per the 10-K disclosure, a 200 bps linear increase in the yield curve as at Q4 2004 would decrease Doral's net interest income by 17% over the next one year. This new disclosure is very different from the 3Q 2004 disclosure, when the bank claimed that the same 200 bps linear increase in interest rates would increase Doral's net interest income by 4.8%. We believe that this change in interest rate sensitivity is driven by three key factors:

Doral's forecast of the impact of rising rates to net interest income is done using the shape of the yield curve at the end of the reporting period. As the yield curve flattened by about 50 bps between 3Q04 and 4Q04, we believe projections based off a flatter curve in 4Q04 vs. 3Q04 contributed about 5% of the 20+% swing in asset sensitivity assumptions between 3Q04 and 4Q04. (i.e. the swing to 17% negative impact on NII due to a 200 bps linear increase in 4Q04, from a 5% positive NII impact in 3Q04)

We also believe that the company's negative funding gap increased to about \$5.0 billion from \$4.0 billion in 3Q04. This increase was primarily driven by a 20% q/q annualized increase in fixed rate securities, and 28% q/q annualized increase in short-term repo funding. Our interest model indicates that this change in the company's funding gap accounts for about 6% of the 20+% swing in asset sensitivity assumptions between 3Q04 and 4Q04.

UBS 10

In order to improve the company's interest rate risk modeling capabilities, Doral made significant enhancements to its modeling program during the fourth quarter of 2004. One of the most significant improvements in the model is that the mortgage loan and mortgage-backed securities portfolios are now segregated by product type, coupon and maturity, and the effect of changes in interest rate is applied to each group separately. The previous model considered these portfolios using a single instrument approach. We believe the changes under the new approach capture sensitivity better than the previous model. In addition, certain of the company's liabilities are callable at the option of the lender. The new model utilizes an option-adjusted spread methodology to enhance its ability to estimate the probability the call will be exercised. The previous model used a static approach to estimate such probability. Under a rising rate scenario, a higher proportion of liabilities are pre-paid and hence re-priced at higher rates with the new model.

In our March 9th report entitled "*After Digging Into Issue, Reiterating our Buy 2 Rating*", we alluded to the fact that Doral's balance sheet is indeed liability sensitive, and that the company could experience a reduction in net interest margins as rates continue to rise. We maintain our prior conclusion that earnings do not appear to be significantly at risk, given the large derivatives position the company maintains to hedge this risk. However, given that Doral became more liability sensitive in Q4, our interest rate model indicates that 2005 net interest margins will most likely average around 200 bps, lower than our previous estimate of 210 bps. This impacts our prior 2005E EPS of \$4.55 and prior 2006EPS of \$5.44 by \$0.08 and \$0.13 respectively.

Slowing Loan Growth

Although Doral originated a record \$2.0 billion worth of loans in Q4 2004 (up 2% q/q), our analysis indicates the growth was driven by originations in the U.S (up 17% q/q) versus in Puerto Rico (down 5% q/q). In Puerto Rico, our analysis also indicates that growth in nonconforming loans (which generates Doral's high gain on sale margin) slowed in 4Q04 by about 12% on a quarter over quarter basis).

We suspect that the slowdown in origination growth at Doral's Puerto Rican operations is partially due to seasonality (previous 4Q results have shown similar downtrends), as well as a stronger than average hurricane season in 2004. However, we believe the slow down is also related to rising interest rates, and increased local competition. As a result, we are reducing our 2005 and 2006 loan growth assumptions to 6% from 12%. This impacts our prior 2005E EPS of \$4.55 and prior 2006EPS of \$5.44 by \$0.12 and \$0.20 respectively.

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Chart 7: Doral – Loan Origination Trends

	U.S Origination	U.S Origination Q/Q Growth	Puerto Rico Origination	Puerto Rico Q/Q Growth	Total Loan Origination	Nonconforming Loan Origination	Nonconforming Loans Origination Q/Q Growth
1Q02	329,469		890,796		1,190,265	371,962	
2Q02	325,391	5%	926,111	5%	1,251,502	454,988	22%
3Q02	372,494	14%	957,069	3%	1,329,563	523,631	16%
4Q02	419,265	13%	978,286	2%	1,397,551	110,482	-79%
1Q03	408,956	2%	1,051,600	7%	1,460,556	562,359	409%
2Q03	433,614	6%	1,172,364	11%	1,605,978	606,850	8%
3Q03	437,060	1%	1,243,939	6%	1,680,999	512,491	16%
4Q03	450,130	3%	1,281,139	3%	1,731,269	659,173	29%
1Q04	515,598	15%	1,325,629	3%	1,841,421	606,653	3%
2Q04	603,050	17%	1,342,274	1%	1,945,324	756,186	25%
3Q04	636,365	6%	1,350,159	1%	1,986,515	789,123	4%
4Q04	742,849	17%	1,287,585	-5%	2,030,434	696,921	-12%

Source: Company Reports

Potential Negative Impact From New Tax legislation

The governor of Puerto Rico proposed new tax legislation on March 15th, 2005, which could result in an increase in Doral's tax rates. The new proposal is part of the governor's overall efforts to reduce the budget deficit. Specifics of the proposed legislation include raising approximately \$180 million from financial institutions through a special 5% tax on the net interest income (NII) of these institutions for the next two years until a more permanent change is made to Puerto Rico's tax code. There is still uncertainty as to the tax rate on NII, as the treasury secretary has subsequently said the final rate would most likely be about half of the current proposal. For our earnings estimates, we have assumed a 5% rate, which results in \$0.10 and \$0.16 impact to our previous 2005E and 2006E EPS estimates.

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Hedging Key To Achieving 2005 EPS

Given the increased exposure to interest rate from the I/O strips, as well as increased negative funding gap, we believe that it is absolutely critical for Doral to be properly hedged against the potential impact of rising rates on earnings.

As mentioned earlier, based on the new 10-K disclosure on derivatives transactions, it appears to us that Doral may have been underhedged against the potential impact of rising rates on the I/O strips. We estimate that the company needed to be long put options on about \$26 million in notional value of Eurodollar deposits to be properly hedged against continued write-downs of \$878 million in I/O strips as at Q4 2004. The bank however only hedges worth \$4.0 million in notional value as at Q4 2004.

Per management, put options on over \$25 million in notional value of Eurodollar deposits was added in 1Q 2005 to hedge the I/O strips. We estimate that the total value of I/O strips however grew another \$50 million in Q1 2005, and believe that Doral may experience about \$75- \$100 million in I/O related charges in 2005 as it continues to attempt to properly hedge its I/O strips. We expect that some of this charge will be partially offset by some success in hedging this risk. There are also interest rate caps and collars that should provide some protection for the I/O strips should LIBOR rates rise more than anticipated (i.e. above 5.0%).

Our quick thoughts on the company's other major hedging positions

Long puts on interest rate futures contracts totaling \$2.4 billion in notional value serves as a hedge for \$5.0 billion in available for sale securities. We believe that this is reasonable, given our belief that the likelihood of selling a large portion of the securities portfolio is low. We believe Doral is more likely to deploy some of its \$2.5 billion cash and money markets balance into higher yielding assets to take advantage of rising rates.

Long puts on bonds and MBS totaling \$1.6 billion in notional value, as well as a short futures position totaling \$320 million in notional value of U.S treasuries and notes, serves as hedges for \$2.1 billion in held to maturity securities. It is our understanding that the duration of the fixed income securities that serve as the underlying instrument for the put options and futures contracts is similar to the duration of Doral's held to maturity securities portfolio.

The company maintains a net pay fixed position of about \$9.3 billion in notional value to hedge its funding costs – mainly \$6.3 million in repos, \$1.3 million in brokered CD's and \$1.3 million in federal home loan advances. The net pay fixed position consists of \$700 million in pay fixed swaps, put

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options on \$1.5 billion in notional value of Eurodollar deposits, and a short futures position on \$7.1 billion in notional value of Eurodollar deposits. We believe that the futures contracts have short durations (typically 90 days till delivery), which matches up fairly well with the duration of the company's repos, which generally reprice every quarter.

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Strong Housing Fundamentals Should Drive Earnings

While the newly proposed tax regulation and increased local competition reduce our overall bullishness on fundamentals in the Puerto Rican banks sector, we continue to believe that the strong housing market which has historically driven Doral's superior earnings growth and stock appreciation should remain in place in 2005.

New home sales in Q4 2004 were up 20% to 3,109 units from 2,592 units in Q4 2003. Geographically, the largest sales increases were seen in the San Juan metro area. We are thus comfortable with the notion that the housing boom in San Juan is not yet slowing, despite the fact that almost 50% of the population lives in this metro area.

We estimate that new home prices increased to \$190,000 in Q4 2004, a 22% increase versus Q4 2003. Across the board growth in the major housing categories indicate that home price increases is broad based. We believe that home price appreciation is a key driver for continued strength in the residential construction and residential mortgage market.

Our proprietary Puerto Rican Housing Affordability Index (PRHAI) increased by 6 pts to 90 in Q4 2004, versus 84 in Q3 2004. While affordability is still at historical lows, we believe current levels are still well above the critical mark where we would be concerned about a housing price correction.

Unemployment remained steady around 11% in January, 2005

Valuation

Reducing 2005E and 2006E EPS to \$4.00 and \$5.00 respectively

We are reducing our 2005E EPS to \$4.00 from \$4.55, and our 2006E EPS to \$4.95 from \$5.44. Our reduction is based on

- Reduction in net interest margins as the company became more liability sensitive in Q404. This has \$0.08 impact on 2005E EPS and \$0.13 impact on 2006E EPS.
- Reduction in our loan origination growth assumptions from 12% annual growth to 6% annual growth. This has a \$0.12 impact on 2005E EPS and \$.20 impact on 2006E EPS.
- Increase in tax rates to reflect the newly proposed tax legislation. This has a \$0.10 impact on 2005E EPS and \$0.16 impact on 2006E EPS.
- Reduction of our 2005E EPS by \$0.25 to reflect the potential for continued losses on I/O strips. We currently estimate a loss of between \$75 million to \$100 million (partially offset by the company's hedging program) as LIBOR rates continue to rise.

Chart 8: 2005E and 2006E EPS Revisions

		2005	2006
Previous EPS Estimate	\$	4.55	\$ 5.44
Increased Rate Sensitivity	\$	(0.08)	\$ (0.13)
Slower Loan Growth	\$	(0.12)	\$ (0.20)
Proposed Tax Legislation	\$	(0.10)	\$ (0.16)
I/O Writedowns (net of hedges)	\$	(0.25)	\$ -
New EPS Estimates	\$	4.00	\$ 4.95

Source: UBS

We also performed an analysis of hypothetical 2005 earnings for Doral, at different valuation levels for the company's I/O strips. We believe the table below shows how critical the value assigned to the I/O strips is to determining 2005E EPS, and the valuation of the company's stock.

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Chart 9: 2005E EPS At Different I/O Valuation Levels

	306	350	400	500	600	700	730
2004 - Total Gain On Sale Margins							
2004 - Total Gain On Sale	250756	287000	328000	410000	492000	574000	598762
2004 - Gain On Sale From Nonconforming Loans	165247	200227	239798	318939	398080	477221	501120
2004 - Implied Fair Value of I/O Strips	0	82187	177516	376086	585956	808118	877787
2005 - Net Interest Income	412401	401443	388733	362257	334274	304652	295363
2005 - Total Gain On Sale Margins (Lower Than '04 Due To Flatter Curve)	201	245	295	395	495	595	625
2005 - Total Gain On Sale	171764	209596	252391	337983	423674	509165	535011
2005 - Non Interest Income	177892	215723	258518	344110	429701	515292	541139
2005 - Total Revenue	590293	617166	647251	706366	763975	819945	836502
2005 - Operating Expense	251601	251601	251601	251601	251601	251601	251601
2005 - Pre-Tax Earnings	338692	365565	395650	454766	512374	568344	584901
2005 - After Tax Earnings	287888	310731	336303	386551	435518	483092	497166
2005 - Dividends On Preferred Stock	33300	33300	33300	33300	33300	33300	33300
2005 - Impact of Coco's	-16388	-16388	-16388	-16388	-16388	-16388	-16388
2005 - EPS	\$ 2.26	\$ 2.45	\$ 2.67	\$ 3.09	\$ 3.50	\$ 3.89	\$ 4.01

Source: UBS. Analysis based off hypothetical valuations of the I/O strips as at 12/31/04, which we then adjust to reflect a flatter yield curve in 2005.

Reducing Price Target To \$30, Maintain Buy 2 Rating

Given the current negative market sentiment regarding gain on sale accounting, we believe that the market will continue to give zero value to Doral's gain on sale business model until management can provide clear evidence that the company's I/O strips are fairly valued. Our expectations are that the market will ascribe a fair value to the I/O strips if 1) management provides more transparency into the assumptions used internally by the company to value its I/O strips 2) management provides transparency into the external valuations done by independent third parties on the I/O strips or 3) management sells some or all of the I/O strips in the MBS market to establish a market price.

Until more transparency is available into the company's I/O valuation (which will determine how much value to give gain on sales going forward), we are valuing Doral based on our cash based EPS model. Our \$30 12- month target price is based on historical 10.5x forward EPS on 2006E cash based EPS of \$2.83. We maintain our Buy 2 Rating.

While we expect the establishment of an independent valuation of Doral's I/O strips to serve as a catalyst for the stock, we do believe that there is the real possibility that the company's stock could face multiple compression giving the challenging interest rate environment. We do not expect Doral to switch its business model from gain on sale to a whole loan sale model anytime soon. This is because a whole loan sale model limits the ability to sell loans to the local commercial banks at a variable pass through rate. Local commercial banks make up about 45% of the buyers of Doral's loans, and require a variable pass through rate for their asset-liability matching requirements. Most of these banks are funded short, and thus desire variable rate assets on their balance sheets. Doral would thus lose a very large and important part of its seller base, if it

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converted to a wholesale loan model. It is also unclear at this point how easy it would be to sell Doral's nonconforming loans to GNMA and the GSE's.

Given our belief that the company will stick to its gain on sale business, we would not be surprised to see Doral's P/E multiple contract to about a 9.0x PE on current year earnings, once a valuation is ascribed to the I/O strips. This multiple would be in a similar range to Countrywide Financial, one of the market leaders in the Alt-A mortgage origination market in the U.S. (most of Doral's nonconforming loans are Alt-A).

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Doral Financial Corp. is a Puerto Rican bank that engages in a wide range of mortgage banking activities, including the origination, purchase, sale and servicing of mortgage loans on single-family residences, and operates bank branches in Puerto Rico and New York City.

Statement of Risk

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Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage ¹	IB services ²
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	Buy 2	FSR is > 10% above the MRA, lower degree of predictability	Buy	36%	32%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	Neutral 2	FSR is between -10% and 10% of the MRA, lower degree of predictability	Hold/Neutral	53%	35%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	Reduce 2	FSR is > 10% below the MRA, lower degree of predictability	Sell	11%	29%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 31 December 2004.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).

Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

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Companies mentioned

Company Name	Reuters	Rating	Price
Doral Financial ^{2,4,16}	DRL.N	Suspended	US\$22.55

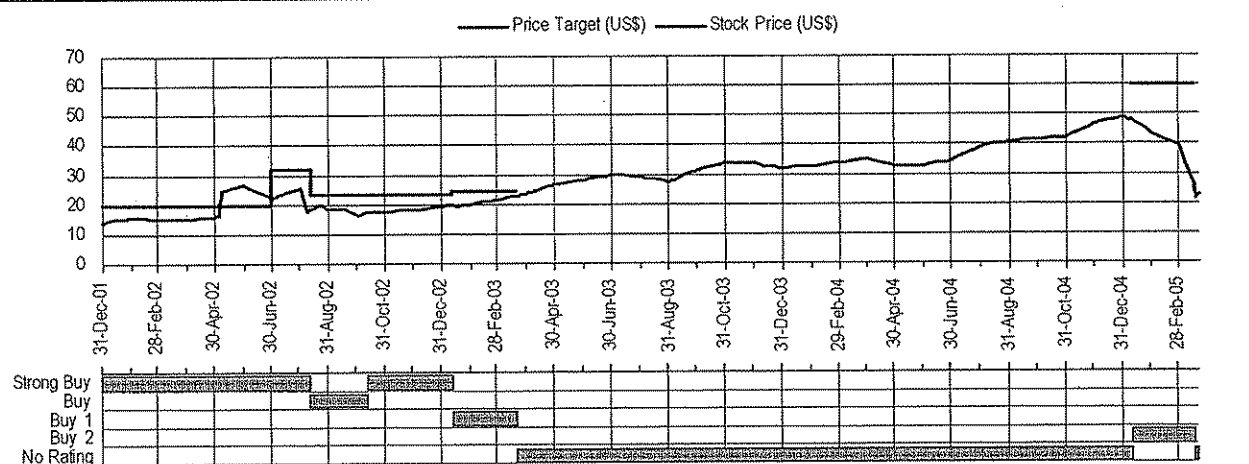
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Price(s) as of 22 March 2005. Source: UBS.

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Doral Financial (US\$)



Source: UBS; as of 22 March 2005.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

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